



Falkirk Council Pension Fund

Annual Audit Plan Addendum
Year ended 31 March 2020

Pensions Committee and Board -
13 August 2020

Introduction

The Impact of Covid-19 on our audit

Our Annual Audit Plan was agreed with management and due to be presented at the Pensions Committee and Board meeting in March 2020 before its cancellation. We provided an overview of our audit scope and approach for the audit of the financial statements and the wider scope audit work. This addendum provides an update to the Pensions Committee and Board on the planned scope and approach to the external audit for 2019/20 in light of the significant impact of the Covid-19 global pandemic on local government.

Our audit procedures have been re-assessed to ensure they address the changing risks and issues which have emerged as a result. Our aim is to deliver a high quality audit while supporting the Pension Fund to prioritise its key functions and obligations. We outline below the key areas of impact for our audit in 2019/20, while recognising that the Pension Fund faces significant uncertainty and developing risks in the months and years ahead.

1. Impact on our audit risk assessment

On page 3, we outline the key areas of impact on the risks presented within our Annual Audit Plan.

We have reviewed our consideration of the overall materiality levels used for the audit and concluded that while planning materiality base level remains appropriate, tolerable error (which is materiality at an individual account level) should be reduced from 75% to 50% of planning materiality due to the increased risks of material misstatements in a remote working environment.

3. Wider scope risk assessment

On pages 6-7, we outline proposals to reprioritise wider scope work to focus on key areas of risk during the pandemic.

2. Impact on the financial statements

On pages 4-5, we highlight our expectations of areas of impact within the financial statements, in particular possible changes to narrative reporting and disclosures to reflect the impact and uncertainty around the current situation.

4. Audit logistics

Schedule 6 of the Coronavirus (Scotland) Act 2020 allows the Pension Fund to postpone the submission of unaudited accounts and publication of audited accounts. On page 8 we set out:

- ▶ Our current expectations that the timetable will be broadly in line with the original plan;
- ▶ The primacy of maintaining audit quality; and
- ▶ Logistical arrangements to allow us to conduct the audit remotely.

1. Impact on audit risk assessment

Changes to our risk assessment as a result of Covid-19

We set out below the significant and inherent risks identified for 2019/20 alongside our other areas of audit focus. We have highlighted any changes in audit focus or new risks alongside any revisions to the expected audit approach. The risks identified may change further as a result of any significant findings or subsequent issues we identify during the audit.

Fraud Risk:

Misstatement due to fraud or error

No change in risk or audit focus, but we recognise that the control environment for financial statement close processes may have evolved due to remote working arrangements. We will assess whether this had an impact on the effectiveness of management's controls designed to address the risk of fraud. Our specific focus remains on key areas of judgements and estimates, significant unusual transactions and journal entries made by management.

Significant risk:

Valuation of complex investments

No change in risk or audit focus. While we recognise there may be additional uncertainty around the bases for valuation of some of the Fund's more complex assets, we already assess this area to be a significant risk to the financial statements and so no further change is required. However, we do anticipate additional work required to gain assurance over some of the assets more subject to valuation fluctuation at 31 March 2020 due to Covid-19.

2. Impact on the Pension Fund's Financial Statements

Our review and reassessment of materiality

We have reviewed our consideration of the overall materiality levels used for the audit and concluded that while planning materiality base level remains appropriate, tolerable error (which is materiality at an individual account level) should be reduced from 75% to 50% of planning materiality.

In our Annual Audit Plan, we communicated that our audit procedures would be performed using a materiality of £49.8 million. We have considered whether any change to our materiality is required in light of Covid-19. Following this consideration we have concluded that materiality base (being 2% of net assets) remains appropriate. Tolerable error has been decreased from 75% to 50% of planning materiality to reflect on the increased risk of material misstatement due to remote working environment. We have also updated materiality figures for the year net assets position reported in the unaudited 2019/20 financial statements. This resulted in setting planning materiality at £46.5 million and tolerable error at £23.25 million. Summary of audit differences threshold remained unchanged (£0.25 million).

Our evaluation requires professional judgement and so takes into account qualitative as well as quantitative considerations. Factors which we consider include the perspectives and expectations of users of the financial statements as well as our risk assessment as to the likelihood of material misstatements arising in the financial statements. We will report any changes to our materiality as part of our Annual Audit Report.

The ongoing disruption to daily life and the economy as a result of the Covid-19 virus will have a pervasive impact upon the financial statements.

The financial statements will need to reflect the impact of Covid-19 on the Fund's financial position and performance.

Accounting policies

Covid-19 has the potential to have a pervasive impact on the financial statements. We have outlined below the areas where we believe there is the potential for the most material impact on the Fund's financial position at yearend:

- ▶ **Investments:** volatility in the financial markets is likely to have a significant impact on investment assets.
- ▶ **Actuarial assumptions:** there is the possibility of significant changes to the underlying actuarial assumptions impacting the valuation of liabilities disclosed under IAS 26.
- ▶ **Receivables:** there may be an increase in amounts written off as irrecoverable, delays in contributions payments and impairment of year-end balances due to the increased number of businesses and individuals expected to be under financial stress.

A number of revised disclosures will be required to reflect the impact of the pandemic, including on the financial position and future financial sustainability.

We will continue to work closely with management to share experience and good practice from other local authorities across the UK.

Key disclosures within the Financial Statements

Management commentary

In recognition of the pressures facing local authorities, the Scottish Government has revised some of the content requirements of the management commentary to ensure that it can be streamlined to focus on the headline financial results for the year, financial position and risks going forward. There is an expectation that future risks will include those arising from Covid-19. Guidance on the revised requirements has been provided within Finance Circular 10/2020.

Governance statement

The Pension Fund moved to critical service delivery in March 2020, with a focus on its core statutory duties. The widespread use of home working may change the way internal controls operate. The governance statement will need to capture how the control environment has changed during the period up until the yearend date 31 March 2020 and what steps were taken to maintain a robust control environment during the disruption, including how key governance functions are continuing to operate, such as key committee meetings and the delivery of internal audit's programme of work.

Accounting estimates and judgements

Additional disclosures may be required throughout the financial statements to reflect the additional risks facing the Pension Fund and how these have impacted the key judgements and estimates made in preparation of the financial statements, in particular with respect to the valuation of investments at 31 March 2020.

Events after the balance sheet date

Significant events after the balance sheet date require to be disclosed within the financial statements, either through the post balance sheet events note or in specific accounting notes or the management commentary and governance statement as appropriate. The detail required in the disclosures will reflect the specific circumstances of the Fund. In particular, one of the areas of possible disclosure expected for the Fund could be movements in the valuations of the investments after the yearend date.

We will review the updated going concern disclosures within the financial statements under IAS 1, and associated financial viability disclosures within the management commentary. We expect any material uncertainties around the Pension Fund's future financial position to be fully disclosed.

Disclosures on Going Concern

International Auditing Standard 570 Going Concern, as applied by Practice Note 10: *Audit of financial statements of public sector bodies in the United Kingdom*, requires auditors to undertake sufficient and appropriate audit procedures to consider whether there is a material uncertainty on going concern that requires reporting by management within the financial statements, and within the auditor's report.

In accordance with the CIPFA Code of Local Government Accounting, the Pension Fund shall prepare its financial statements on a going concern basis unless informed by the relevant national body of the intention for dissolution without transfer of services or function to another entity. Covid-19 has created a number of financial pressures throughout local government, including Pension Funds but also Fund employers, and uncertainty remains about the level of financial support that may become available from the Scottish Government to reflect the financial consequences of Covid-19. CIPFA bulletin 05 (closure of the 2019/20 financial statements) states that while there is likely to be a significant impact of Covid-19 on local authority financial sustainability, the rationale for the going concern basis of reporting has not changed.

However, in light of the unprecedented nature of Covid-19, there will be an increased focus on management's assertion regarding the going concern basis of preparation in the financial statements, and particularly the need to report on the impact of financial pressures on the Pension Fund and its financial sustainability going forward. Management's assessment and associated disclosures will need to cover at least a 12 month period from the date of approval of the financial statements.

Disclosures made in the financial statements should include the process that has been undertaken to revise future financial plans and cashflow in the light of Covid-19 and the outcome of this. Consideration should also be given as appropriate and material to liquidity forecasts, sensitivities in forecasting, mitigating actions (including but not restricted to the planned future use of funds), and key assumptions made by management, such as the assumed duration and impact of Covid-19 on the Pension's Investment values.

Our audit procedures to review these disclosures will include consideration of:

- ▶ The current and developing environment;
- ▶ The Fund's liquidity (operational and funding);
- ▶ Mitigating factors and actions identified by management;
- ▶ The robustness of management information and forecasting; and
- ▶ Sensitivities and stress testing.

3. Wider scope risk assessment

Wider scope risk assessment

We have outlined below our assessment of the impact of the pandemic on the work planned under wider scope dimensions.

Financial sustainability

We will consider the Fund's response to the impact of Covid-19 on investment valuations, the potential impact on longer term funding plans, and what steps the Fund has taken to date to address the new uncertainty around investment valuations and funding levels going forward. The next triennial valuation is scheduled to take place as at 31 March 2020. We will assess the impact that Covid-19 has had on preparations for the valuation exercise. We will also assess how the Fund has engaged with admitted and scheduled bodies in relation to the affordability of contributions, particularly for smaller bodies as a result of Covid-19.

Financial management

We will consider and report on the Fund's arrangements in respect of financial monitoring, review and reporting through the year and controlling its income and expenditure. In particular we will evaluate how the Fund's financial management arrangements have changed in light of the change in working arrangements and the robustness of its arrangements to monitor and revise financial results and planning going forward.

Governance and transparency

In our 2018/19 Annual Audit Report we concluded that the key features of good governance were in place and operating effectively. No significant risks were identified in relation to this dimension. Our work for the year will be prioritised to consider:

- ▶ Internal audit arrangements during 2019/20, including significant findings identified and the work done to address issues identified;
- ▶ The quality of reporting and information provided to key decision makers both before and during crisis; and
- ▶ The Fund's arrangements to adapt to the impact of Covid-19 on the usual governance arrangements, and the adequacy of disclosures within the Annual Governance Statement to reflect the impact of the Covid-19 pandemic on governance.

Value for money

We did not identify a specific significant risk in relation to value for money. We will continue to assess the steps taken by the Fund to monitor Fund manager performance and review the governance processes for making any changes, while remaining pragmatic and flexible.

4. Audit Logistics

Changes to reporting timescales

Finance Circular 10/2020 advises that 30 November 2020 should be considered a reasonably practicable date for publishing the audited accounts.

Audit quality retains primacy over regulatory deadlines.

Schedule 6 of the Coronavirus (Scotland) Act 2020 allows the Pension Fund to postpone submitting the unaudited accounts to auditors and publishing the audited accounts until it is reasonably practicable. The Financial Reporting Council (“FRC”) has issued guidance for both auditors and preparers of the financial statements on issues arising from the Covid-19 pandemic. The guidance to date highlights the practical difficulties in preparing financial statements and performing audits in the new way of working. It is clear that auditors will be required to develop alternative audit procedures to gather sufficient and appropriate audit evidence.

The guidance is clear that the new way of working should not undermine the delivery of high quality financial statements preparation or quality audits, which should continue to comply fully with international auditing standards. Where additional time is required to complete audits due to ongoing and developing risks, it is important that this is taken to maintain audit quality rather than seeking to conclude early to meet arbitrary or regulatory deadlines.

The Pension Fund is currently planning to work to the original timetable for both the publication of the unaudited accounts, and the audit and finalisation of the audit financial statements by the end of September 2020. To date management has demonstrated that there has been no slippage in planned work around the preparation of the financial statements, and we will continue to work with management to meet these timetables and keep them under review through the audit process.

Information produced by the entity (IPE)

There will be an increased focus around the completeness, accuracy, and appropriateness of information produced by management to support our audit work due to the inability of the audit team to verify original documents or re-run reports on-site from the Pension Fund’s systems. To address the risks around this we will consider the following procedures as appropriate:

- ▶ Use screen sharing functionality to evidence re-running of reports used to generate the IPE we audited;
- ▶ Agree IPE to scanned documents or other system screenshots; and
- ▶ Should it be necessary agree limited onsite visits under appropriate arrangements to verify specific requested documentation and reports in person.

Fee variations will be agreed with management and reported to the Audit Committee in our 2019/20 Annual Audit Report.

Audit fees

The expected base fee for the Pension Fund, set out in our Annual Audit Plan, assumes there is no major change in respect of the scope of work in the year, that the Pension Fund has sound governance arrangements in place and operating effectively throughout the year, prepares comprehensive and accurate draft financial statements and supporting schedules, and meets the agreed timetable for the audit, and an unqualified audit opinion resulting from the audit. Should any of these circumstances change throughout the audit, it is expected that additional costs will be incurred through the course of the audit which will be subject to recovery in line with the agreed process and rates set out by Audit Scotland.

The changes to the Fund and the associated risks to the audit outlined in this addendum will have an impact on the audit work we need to perform to conclude on the financial statements, in particular:

- ▶ The impact of Covid-19 on the financial statements audit, including the requirement to reassess our audit planning work in full in the light of Covid-19 and the expected additional work required to conclude on the valuation of Fund investments at 31 March 2020; and
- ▶ Additional work required around the appropriateness of going concern and other Covid-19 related disclosures in the financial statements and the associated wider scope audit consideration required around financial management and sustainability.

At the time of drafting this report it is not possible to quantify the impact of Covid-19 on the financial statements accounting and audit requirements. Any additional audit costs will be in line with the process and day rates set out by Audit Scotland, agreed with management and reported to the Audit Committee through our Annual Audit Report.

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